

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
A. H. ISENBERG)

Appearances:

For Appellant: Edward R. FitzSimmons,
Attorney at Law

For Respondent: James W. Hamilton,
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of A. H. Isenberg against a proposed assessment of additional personal income tax in the amount of \$1,782 for the year 1951.

Appellant's grandmother died in Germany in 1934, leaving him a number of Reichsmarks (hereafter referred to as RM) which were deposited in his name in the Norddeutsche Bank at Hamburg, Germany. Until the year 1951 the RM were blocked by law from being converted into dollars and it does not appear that there was any means of exchanging the RM for American money. If there was a market for such blocked currency at the time it was credited to his account, Appellant has not offered any evidence of its market value.

On December 11, 1941, the United States declared war with Germany. Although the RM had remained blocked from conversion into dollars at all times after Appellant inherited them, the Reichsbank of Germany established a rate of exchange which, in 1941, was 2.50 RM to \$1.00. As of December 31, 1947, after Germany was defeated in World War II, Appellant had 72,804.20 RM in his account, which, according to a bank statement from the Norddeutsche Bank were then valued at 2.40 RM to \$1.00, that is, \$30,327.

In 1948, the Allied Forces instituted a currency reform under which a new currency, Deutsche Marks (DM), was substituted for RM in the ratio of 6.5 DM for 100 RM and Appellant's account was adjusted accordingly. The dollar exchange rate as set by the Joint Import Export Agency was 3.33 DM to \$1.00.

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In August 1951, Appellant converted 4,360.90 DM into dollars, receiving the sum of \$627. He deducted in his income tax return for that year the amount of \$29,700 as a loss on the conversion.

Respondent has disallowed the deduction on the grounds that the loss did not occur in 1951 but on December 11, 1941, when war was declared by the United States with Germany, or in 1948 when the currency reform was instituted.

In 1943, the Legislature enacted provisions intended to cover the deduction of losses resulting from war. These provisions, which were in effect until 1955, stated in part that "Property within any country at war with the United States, ... shall be deemed to have been destroyed or seized on the date war with that country was declared by the United States." (Originally, Personal Income Tax Act, § 8.3, subd. (2), and later, Rev. & Tax. Code, § 17329 and Rev. & Tax Code, § 17330.4, successively.) Identical provisions of the Internal Revenue Code have been held to establish conclusively the time of the loss. (Wyman v. United States, 166 F. Supp. 766.)

The California statute was expressly made applicable to all years ending after December 6, 1941. (Stats. 1943, ch. 353, § 130(i).) Recognizing that there is a question whether the legislation could constitutionally apply retroactively to 1941 (see 4 Ops. Cal. Atty. Gen. 173), Respondent contends that the above quoted language simply clarified the law as it existed in that year. Respondent particularly relies on Wyman v. United States, supra. The court there stated that the Federal statute "can be regarded as merely codifying prior case law as to what constitutes a loss, viz., loss of control over and possession of property." (p. 774.)

Appellant's position on the application of the statute has not been made clear. He states in his brief that "Immediately with the declaration of war on that date, with property located in Germany, the Appellant sustained a war loss." His position appears to be that the loss was nevertheless not realized until he converted the marks into dollars,

In accordance with our well established policy in appeals involving unpaid assessments, we must accept the validity of the statute in order to allow the possibility of judicial review of the constitutional question. (Appeals of Margaret R. and Jules V. Van Cleave, Cal. St. Bd. of Equal., May 11, 1955, 2 CCH Cal. Tax Cas. Par. 200-346, 3 P-H State & Local Tax Serv. Cal. Par. 58095.) The policy is particularly apt in this case, where the Appellant has not squarely alleged or argued that the statute is unconstitutional.

Accepting the statute as valid in its application to the year 1941, Appellant realized a loss of the entire property in

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that year. (Wyman v. United States, supra.) In order to establish a subsequent loss, he must show that he recovered the property, the date that he recovered it, and the fair market value at the time of the recovery, which then becomes his basis for computing a later loss. (Personal Income Tax Act, §8.3, sub. (d), effective 1943 to 1945; Rev. & Tax. Code, § 17346, effective 1945 to 1955; Dezso Goldner, 27 T.C. 455.)

There is no presumption that Appellant recovered his property upon the cessation of hostilities. (Dezso Goldner, supra.) And if there was a recovery at some time before Appellant converted the DM into dollars, there is nevertheless no adequate evidence of the fair market value at any time before the conversion.

Since the RM were blocked, the value of \$30,327 placed upon them in 1947 is obviously wholly artificial. This value was based upon an exchange rate even more favorable than that set by the Reichsbank in 1941, before Germany's defeat.

The currency reform of 1948 confirmed the inflated position of the RM by providing for an exchange at the rate of 100 RM for 6.5 DM, which in turn were assigned an exchange rate of 3.33 DM to \$1.00. This would indicate a value of approximately \$1,309 for the DM in question and the same value for the equivalent RM previously in Appellant's account.

Even though the latter figure is more realistic, a further reduction should be made in estimating the market value to account for the fact that the currency was not in fact convertible to dollars until 1951. In Credit & Investment Corp., 47 B.T.A. 673, similarly blocked German marks were found to have a value in 1936 of less than 40 percent of the value indicated by the official exchange rate.

Thus, assuming that Appellant recovered his inheritance at some time after the end of the war and before he converted it into dollars, it appears that his basis did not exceed the amount he received in dollars, \$627. It follows that no deductible loss occurred upon the conversion.

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O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of A. H. Isenberg to a proposed assessment of additional personal income tax in the amount of \$1,782 for the year 1951 be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of October, 1963 by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: H. F. Freeman, Executive Secretary